CAPITAL PROJECTS AND BOND OVERSIGHT COMMITTEE

Minutes

December 18, 2007

The Capital Projects and Bond Oversight Committee met on Tuesday, December 18, 2007, at 1:00 PM, in the Auditorium of the State Office Building in Frankfort, Kentucky. Senator Elizabeth Tori, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Senator Elizabeth Tori, Co-Chair; Representative Mike Denham, Co-Chair; Senators Tom Buford and Dan Seum; and Representatives Robert Damron, Steven Rudy, and Jim Wayne.

Guests testifying before the Committee: Kim Oatman and David DeVoss, Murray State University; Terri Fugate, Office of Financial Management; Katie Smith, Cabinet for Economic Development; Larry Owsley, University of Louisville; Bob Wiseman and Bill Harris, University of Kentucky; John Hicks, Governor's Office for Policy and Management; Jim Abbott and Nancy Brownlee, Finance and Administration Cabinet; Sandy Williams and Tim Thomas, Kentucky Infrastructure Authority; Walter Clare, Kentucky Housing Corporation, and Susan Harrison, LDG Development.

LRC Staff: Nancy Osborne, Shawn Bowen, Kristi Culpepper, and Lesa Prewitt.

Representative Wayne made an amendment to the November 20, 2007, minutes. In explaining his "No" vote to approve an unbudgeted project funded 100% with federal funds for the Department of Military Affairs to expand the helipad and taxiway at the Bluegrass Station in Lexington, he had said his vote was because the Iraq war was "unjust, illegal and immoral", and the record should so reflect.

Representative Wayne then made a motion to approve the minutes of the November 20, 2007, meeting as amended. The motion was seconded by Senator Seum and approved by voice vote.

Senator Tori said Jonathan Miller, recently appointed Secretary of the Finance and Administration Cabinet, could not attend the meeting due to another obligation.

Senator Tori asked Nancy Osborne, Committee Staff Administrator, to review the correspondence and information items. Ms. Osborne said the first item of correspondence was from the Kentucky Infrastructure Authority (KIA) in response to questions raised at the November 20, 2007, meeting. The next item of correspondence was from the Office of Financial Management reporting a supplement to the conduit bonds for the Louisville Arena project that was approved by the Kentucky Economic Development Finance Authority (KEDFA) on December 13 and by the Kentucky State Property and Buildings Commission on December 17. The supplement changes the series designation of the bonds from 2007 to 2008 and extends the authorized final maturity by no more than three years. As explained by correspondence from the Office of Financial Management, the extension is necessary in order to achieve the desired underlying ratings on the bonds.

The next information item was an Advisory Opinion from the Executive Branch Ethics Commission regarding the sale of naming rights for the Kentucky Horse Park Indoor Arena. At the Committee's July meeting, questions were raised as to whether there is or should be a state policy on the sale of naming rights for state-owned facilities. The Finance Cabinet said at the Committee's November meeting that they found no stated limitations to the sale of those naming rights, and had asked the Ethics Commission for guidance on ethical considerations.

The Opinion from the Ethics Commission states that the sale of naming rights may be done (1) if it is competitively bid pursuant to the state's Model Procurement Code and (2) if there is an overriding public benefit. The Opinion concluded with the following: "The Commission does warn however that although such a public/private partnership to name buildings is allowable in this case and will be awarded in a fair and impartial manner, it is a trend that is somewhat disturbing to the Commission as it does reflect an endorsement that will forever remain with the state agency."

Relative to the Louisville Arena Authority's decision to delay the issuance of the bonds until 2008, Representative Wayne asked if the decision was related to Wall Street's grading of the bonds. Terri Fugate, Deputy Executive Director, Office of Financial Management (OFM), and Katie Smith, Deputy Commissioner, Cabinet for Economic Development, came to the table. Ms. Fugate said it was her understanding that due to a volatile market, the Authority decided to delay issuance of the bonds until the market stabilized. She said the rating process is on-going.

Representative Wayne said he understood the bonds must have a grade of at least BBB for Ambac to insure the bonds, and asked if ratings had been received. Ms. Fugate said no ratings had been received.

In response to another question from Representative Wayne, Ms. Smith said review of the revenue streams to be generated under the tax increment financing (TIF) may be why the Authority wanted to extend the maturity on the bonds. She said there is a possibility that in the early years of the TIF, it may not generate as much revenue as anticipated. Also, she said the Authority was waiting until early January 2008 because the market may be better for selling the bonds. Ms. Fugate added that there may be a lag in the timing as to when the TIF revenue would be generated, but the projected funding is expected to come in future years.

Senator Tori asked for further explanation of the necessity to extend the bonds and asked if it was a conduit bond. Ms. Fugate said it was a conduit bond to be issued through KEDFA so it could have tax-exempt status. Ms. Fugate said they were looking at capitalized interest for 3 1/2 years and a 30-year bond maturity, but for the comfort of the rating agencies and others, it was agreed to extend the term of the bonds for another three years if needed for flexibility purposes.

Senator Seum asked if these changes would slow the project down. Ms. Smith said the changes would not slow the project down.

In response to a question from Senator Buford, Ms. Fugate said Goldman Sachs, the underwriter, will work with the Authority to decide when to go to market with the bonds. Senator Buford asked who would oversee this project in the new administration. Ms. Fugate said she did not know, but noted that in the November Committee meeting when these bonds were approved, Mr. Jim Host, Chairman of the Louisville Arena Authority, and others promised to update the Committee on the project's progress. Senator Tori said the Committee would request Mr. Host to return to discuss the bonds.

Representative Damron asked if Moody's and S&P requested the three-year additional extension. Ms. Fugate said she did not know the details of which rating agencies this was being discussed with as she had not been involved in the discussions. Ms. Smith said she only knew of one time where KEDFA had issued a bond with a 33-year term; typically conduit bonds have a 30-year term. Representative Damron said according to the *Courier-Journal*, the cost of the financing package had now increased by $90 million. He said the Committee had a lot of concerns relative to the TIF because its revenue streams were unproven. He further stated that the rating agencies were nervous about it as well, and it appears that they continue to be very nervous about it.

Representative Damron said he thought there was a provision that the taxpayers of the Louisville Metro government would pick-up some of the debt service if the TIF does not work. He said there are some tough questions and the rating agencies are concerned.

Representative Wayne said his concern with the Louisville Arena Authority is the level of oversight being provided. He said the Airport Authority in Louisville also consisted of special taxing districts similar to this one. He said he was concerned that the public may not know everything it needs to know.

Representative Wayne observed that if his and Senator Seum's constituents have to pay for a portion of the debt service on the bonds should projected revenues be insufficient, there may be pressure on the state to bail out the project. He said he thought there are danger signs present right now, and legislators should investigate thoroughly. If the Committee can monitor the project closely now, perhaps a catastrophe can be avoided.

Ms. Fugate said in her experience with any agency-fund supported debt or bonds, there is a long process with the rating agencies and insurers, and it is not uncommon for the timing to be extended to get the structure and the bond deal completed. Since there is a new type of revenue stream supporting the bonds, the bond issue warrants additional review.

In regards to the correspondence relating to the Ethics Commission's ruling concerning naming rights of state facilities, Representative Wayne said the Commission may be giving signs that they may need legislative guidelines. He said the Committee may need to co-sponsor some guidelines.

Senator Tori next asked Jim Abbott, Commissioner, Department for Facilities and Support Services, to present an overview of the State Office Building. Mr. Abbott said he was happy the Committee could meet in the newly renovated building and was looking forward to taking the Committee on a tour of the third floor and the roof. He said he wanted the Committee to see the renovation inside of the building but also wanted them to see the how the Frankfort environs surrounding the building's vicinity had changed.

Mr. Abbott discussed the long-term space plans of the state relative to the owned and leased state facilities. He said the renovation work at the CHR complex had been completed using energy saving performance contract funds along with maintenance funds. He said the completion of the Transportation Building and a central utility plant, operational since 2003, allowed the State Office Building tenants to be moved into the new facility thus allowing for the renovation of the State Office Building. The 25,000 SF Jones building adjacent to the Cold Harbor Building was also recently renovated, and the Commonwealth Office of Technology staff are being moved into that space from leased property. These moves decreased the amount of leased property and alleviated overcrowding.

Mr. Abbott said there was a need to address the Capital Plaza Complex, which consists of four parking garages, the civic center, fountain place shops, and the office tower. This is a very complex project, particularly relative to addressing the functional obsolescence associated with the tower. He said the legislature has provided the funding for design and construction funding will be sought in 2010. Mr. Abbott added that the Capitol is an aging building and also in need of remodeling. These needs have been identified in the Department for Facilities and Support Services' Six-Year Capital Plan.

Mr. Abbott said the last item to complete the plan to reduce the state's dependency on leased property is to build an additional state office building of about 400,000 SF with modular accommodations. He said the goal of the long-term plan has always been to reduce the amount of leased space to 15% of the state's overall space use. Mr. Abbott said they are on target to achieve this goal, which is evident with the remodeled State Office Building that is much more functional and accommodating to the staff and the public. He said they look forward to working with the Committee to address these future needs.

Senator Tori said at its January meeting, the Committee would hear a presentation by the Co-Chairs of the Capital Planning Advisory Board on its recommended 2008-2014 Statewide Capital Improvements Plan, which would include the projects discussed by Mr. Abbott and other capital project needs of the state.

Kim Oatman, Director of Facilities Design and Construction, and David DeVoss, Director of Public Safety, Murray State University (MuSU), reported a $300,000 restricted funds scope increase for the Construct Public Safety Building project. This project was authorized in the 2004-06 budget for $1,500,000 (restricted funds) and reauthorized in the 2006-08 budget with additional funds of $500,000 (restricted funds).

Mr. DeVoss said the project is an 8,339 SF building to replace the current facility, a 40-year old former restaurant building. Five bids were received ranging from $2.1 million to $1.95 million. The scope increase is needed to award a construction contract.

Representative Rudy made a motion to approve the scope increase. The motion was seconded by Representative Wayne and passed by unanimous roll call vote. The revised project scope is $2,300,000.

Senator Tori asked Larry Owsley, Vice President for Business Affairs, University of Louisville (UL), to discuss four UL project reports. Mr. Owsley first reported UL plans to use the construction management-at-risk project delivery method for the Papa Johns Cardinal Stadium Expansion project. This restricted funds project was authorized for design in the 2004-06 budget for $2,000,000. Mr. Owsley said a Request for Proposals was issued on October 9 for construction manager services during the design phase. UL has authorization for design, and no expenditures for construction will occur until they have General Assembly authorization. No Committee action was required.

The second item Mr. Owsley reported was a $480,000 scope increase for the Expand Trager Field Hockey Stadium project that was authorized in the 2006-08 budget at a scope of $3,200,000 in Athletic Association funds. The scope increase will also be funded from the UL Athletic Association. UL is experiencing tremendous increases in construction costs in the Louisville market because of all the on-going construction. Mr. Owsley provided the Committee with information about the market's cost inflation.

Representative Denham made a motion to approve the scope increase. The motion was seconded by Senator Seum and passed by unanimous roll call vote. The revised project scope is $3,680,000.

Mr. Owsley next reported a $750,000 scope increase for the Renovate and Purchase Home of the Innocents project. This project was authorized in the 2004-06 budget at a scope of $8,031,000 (agency bonds). The scope increase will be funded from restricted funds and is needed to purchase and renovate the existing facility.

Senator Buford made a motion to approve the scope increase. The motion was seconded by Representative Denham and passed by unanimous roll call vote. The revised project scope is $8,781,000.

The last item Mr. Owsley reported was the sale of the Reynolds Building located on the edge of the UL Campus. In 1958, the Reynolds Metal Company gave UL the facility that has been used for various university functions. UL's master plan recommends alternative uses for this industrial building. After looking at a number of proposals, the university decided to competitively bid the renovation of the building and subsequently sold the renovated facility to the developer, the McGoodwin Company, for $1.3 million.

Senator Tori asked Mr. Owsley to discuss UL's plan to develop student housing. Mr. Owsley said UL has gone from 1,800 beds on campus in 1999 to 3,300 beds in 2007. This was accomplished with projects authorized through the state budget process. Dr. Ramsey, President of UL, has asked for a plan to increase the number of beds by 1,500 to a total of 4,800 beds by 2015. Mr. Owsley explained that UL is landlocked and decided to rely upon the private sector to the extent possible to develop the beds.

In October 2007, UL issued an RFP to solicit private interest to construct and operate housing for students at the developer's financial risk. The university would partner with a developer in terms of having university staff provide residential programs in the facility, but UL would not own, maintain, or operate the facility and would not be responsible for debt service. UL received four responses from developers and has narrowed the decision down to two proposals at this point. Mr. Owsley said structuring housing projects in this way provides housing in a manner that does not add to UL's liability or the state's, but at the same time provides housing near the campus.

Representative Damron asked if construction projects would be less costly if the university had the flexibility to issue its own bonds. Mr. Owsley said the university has not done a clear analysis but this probably would be a factor in the cost. It costs more for the private developers to borrow money as they do not have tax-exempt status.

Representative Damron said it is less expensive for the state to build a project with bonds, rather than lease it. It is also less expensive for the university to build the dormitories and have total control over the quality of construction and the payment of prevailing wages. Mr. Owsley responded that at this time, that is not an option.

In response to questions from Senator Buford relative to the sale of the Reynolds Building, Mr. Owsley said the property being sold is on Third Street, on the edge of the south side of the campus, and bounded by two railroad tracks. He said UL wanted to sell it because it is an odd shaped lot and renovation estimates ranged from $7 to $12 million. UL wanted to look at ways to take underperforming assets and make them performing. In this case, UL got $1.3 million and critical housing was created by the private sector.

Senator Buford said it appears that the property has already been converted into 77 condominiums and then sold to the developer for $1.3 million. Mr. Owsley said UL and the developer had initially executed a long-term lease with an option to extend. He explained that a leasing structure is done in a lot of larger localities, but that structure was impacting the developer's ability to market the condominiums since the developer could not convey an ownership interest.

In response to a question from Senator Buford, Mr. Owsley said the condos had been renovated over the past 18 months. Senator Buford noted the high appraisal on the building was $825,000 and the second appraisal was $325,000. He asked if this amount represented the value of the condos. Mr. Owsley said the appraisal was for the shell of the building prior to any renovations, which was a four-story building that had a lot of asbestos and hazardous waste problems. The McGoodwin Company spent $8 million to build the condominiums. Mr. Owsley said the lease was for 99 years with an option to renew for 99 more years. By selling the property, the university is getting the present value of the stream of payment upfront, which is a good business deal for UL. Senator Buford commented that it was unusual for a university to sale land adjacent to its campus.

Representative Wayne commented that each time he drives by the building it is very dark. Mr. Owsley said that the McGoodwin Company had sold 11 or 12 condos, but he is confident sales will pick up. No action was required by the Committee on this item.

Senator Tori next asked Bob Wiseman, Vice President for Facilities Management, University of Kentucky (UK), and Bill Harris, Director of Purchasing, UK, to report a new lease of space for UK. Mr. Wiseman said UK proposes to lease an off-campus data center being built at the Coldstream Research Farm. UK has authorization for the lease and it is within the $2 million per year budget. UK currently has two on-campus data centers, one in McVey Hall built in 1928 and the other at the Medical Center, which have outgrown their capacity and have critical issues associated with redundant power. The data center in McVey Hall runs all critical operations. UK has not declared this an emergency but does consider this an emergency relocation due to the critical nature of the systems and the problems in the existing buildings. In the summer of 2007, UK's independent consultant recommended immediate action.

Mr. Wiseman said a RFP was issued late last year, and offers were received in February 2007. Three responses were received and the lowest cost responder was Lexhold, which proposed to lease 70,500 SF of a facility it was constructing on the UK-owned Coldstream Research Farm. Mr. Wiseman said in 2005, Lexhold leased an 18-acre tract on the Coldstream campus and is constructing two buildings that Lexhold plans to lease. He said UK will lease 42% of one of the buildings or 21% of the two-building complex. The lease will be for a period of eight years at the same rate beginning on the date of occupancy, and includes non-automatic options to renew beyond the original term with negotiated rates. He said the total amount of the lease is $1,624,880 annually, which amounts to $23.05 square foot for a highly technical data center that meets the Uptime Institute's Tier IV standards. The cost of the lease will be funded with restricted funds from the university (two-thirds) and university hospital (one-third).

Senator Tori asked why the university did not build the data center itself. Mr. Wiseman said UK does not have authority for debt within the existing state budget. He added that UK has a formal debt policy and a debt committee that determines the projects for which debt will be issued and in what amounts. Given UK's needs for debt financing of housing, parking, building renovations, and deferred maintenance, the data centers were not a top priority. He added that UK's annual lease payments under this proposal will be about $1.6 million, whereas a 20-year bond issue for a $40 million building would have cost $3.2 million per year. UK looked at this from a cash flow basis and for these reasons, it was the approach the university wanted to take.

Representative Wayne asked if the facility was being constructed by the private developer on state-owned land with prevailing wage. Mr. Wiseman said prevailing wage is not being paid on this project since UK is only leasing a portion of the development. He said there are four criteria that would argue for prevailing wage: 1) if it is on state land; 2) whether the university will own the building; 3) whether the university will maintain the building; and 4) whether the building is totally devoted to a university or state purpose. In this case, the university is the minority tenant and will not own the building.

Representative Wayne asked whether the court had ruled in the lawsuit regarding the state paying prevailing wage on state park projects. Ms. Osborne said to her knowledge, the temporary injunction was in place and there had been no final ruling.

Representative Wayne said any attempt to get around paying prevailing wage is unjust and there is a moral question in regards to justice for the worker. He said it speaks volumes that UK would take that position. Mr. Wiseman said the university takes the prevailing wage statutes seriously. Representative Wayne said he understood it was taken seriously from a people point of view but he was speaking of a moral point of view. He said we need to rise above university guidelines.

In response to comments from Representative Damron, Mr. Wiseman said if UK built its own data center it would cost approximately $40 million. Representative Damron asked if UK was getting less space. Mr. Wiseman said UK will be getting more space. Representative Damron said it made no sense why someone would lease to the university for $1.7 million per year if the debt service to the lessor is going to be $4 million per year. Mr. Wiseman said the private developer was constructing the building at what UK thought was a good price for the amount and type of space.

Representative Damron commented that in Lexington, the question of whether the prevailing wage statutes apply is not a factor because the cost of construction is so much in demand that people effectively already pay the prevailing wage.

Mr. Harris said UK received three responses to the RFP and two respondents offered to construct buildings in which UK would be the single occupant. Had either of these two been selected, UK would have been the only occupant in the building and the project would have triggered the prevailing wage statutes.

Representative Damron asked if anyone had analyzed the major differences in these bids. Mr. Wiseman responded UK had a long review process, and each responder went through an oral interview process and each proposal was reviewed in depth.

Representative Damron asked how a developer could construct a building wherein the annual debt service is greater than the value of the lease. Mr. Wiseman said he was assuming the developer still has the other 60% of the building they could rent. Representative Damron said if that was the case, UK could lease the other 60%. Mr. Wiseman said the other criteria that UK used was how a data center would look in ten years. If the university had built a data center in 1987, the assumptions UK made would have been different than that what is needed in 2007.

In response to additional comments from Representative Damron regarding the lease, Mr. Wiseman said he thought this was a well-crafted lease throughout the process. Mr. Harris said he assumed that the developer's lenders would do due diligence as well and was therefore confident of the financial viability of the project.

Senator Seum asked if the universities were allowed to do their own bonding would they still have to pay prevailing wage, and if so, who would ensure compliance. Mr. Wiseman said he thought universities would still be required to pay prevailing wage if they did their own bonding. Mr. Harris added that the Labor Cabinet follows up on complaints. Representative Damron said if universities did their own bonding, there are a variety of ways prevailing wage compliance could be policed.

Senator Buford made a motion to approve the new UK lease. The motion was seconded by Representative Damron and passed by roll call vote. Six members voted affirmatively and one member voted "No".

Senator Tori asked John Hicks, Deputy Budget Director, Governor's Office for Policy and Management (GOPM), and Mr. Abbott to present a project report on the Frankfort State Office Building. Mr. Abbott said the renovation of the Frankfort State Office Building (Old Transportation Building) was nearly complete, and now includes an expansion of the parking lot due to the addition of 400 employees in the facility. The former State Office Building housed 800 people and now has the capacity to house 1,200. Also, to supplement the Revenue and Personnel Cabinets' operations, the state-owned warehouse on Barrett Avenue will be renovated at a cost of $900,000. The renovated space will be used to store tax files currently stored in leased space at the Fair Oaks Building and to house mailroom operations currently housed in the State Office Building.

Representative Denham complimented Mr. Hicks and Mr. Abbott on a job well done and said that he was amazed at the work that had been done on the State Office Building. Mr. Abbott said a number of very dedicated state employees worked on this project. He added that the project was under budget and he hoped the state could be proud of the renovation for years to come. No action was required from the Committee.

Nancy Brownlee, Director, Division of Real Properties, came to the table to discuss the lease reports. Ms. Brownlee first reported as information items two lease modifications for consolidation purposes that are contingent upon 2008 legislative approval and appropriation of funding. The lease modification (PR-3882) proposed for the Environmental and Public Protection Cabinet (EPPC) in Franklin County is possible due to the move of the Revenue Cabinet (Revenue) from leased space at Fair Oaks to the renovated State Office Building. The modification provides for suspension of rental payments between dates of occupancy by Revenue and EPPC, a change in agency occupants from Revenue to EPPC; a decrease of 74,924 square feet in leased space from 211,495 SF to 136,571 SF; a decrease in the lease rate from $9.37 to $9.08 SF; and the addition of two automatic extension terms expiring July 30, 2012.

Ms. Brownlee said the proposed consolidation by EPPC will allow cancellation of six existing leases housing approximately 550 staff. She noted that the lessor agreed to provide rent-free storage space while the present tenants were relocated to the State Office Building and the proposed occupancy by EPPC is addressed.

Ms. Brownlee said the decision was made to modify the existing Revenue lease rather than bid the project for several reasons: the building was already under lease by the Commonwealth, the location is close to other EPPC leases including the recent lease of the Unisys building, and the unlikely chance of locating an existing building of scale to accommodate the proposed consolidation. She said if the project was bid, new construction would logically be the only proposal for a building of this size. The cost of new construction for office space range from $10 to $15 per SF and it is not sound policy to have a developer construct a new building when an existing building is available to lease. She added that the proposed rental rate, $9.08, is also less than a newly constructed leased building. Ms. Brownlee said if funding is not approved for this proposed consolidation project, the lease will be canceled entirely and it will cost nothing.

Senator Tori asked Ms. Brownlee if funding was received, when will the agency move. Ms. Brownlee said the target date is July 2008. No Committee action was required.

The second lease modification reported (PR-3386) for the Department of Corrections (Corrections) in Franklin County is possible due to the move of Revenue from 44,528 SF of leased space at Perimeter Park to the renovated State Office Building. The modification provides for suspension of rental payments between dates of occupancy by Revenue and Corrections; a change in agency occupants from Revenue to Corrections; an increase in the lease rate from $9.25 to $12.89 SF for agency-requested fit-ups estimated at $1,157,000 and amortized over the term of the lease; and eight automatic extension terms expiring July 30, 2016.

Ms. Brownlee said Corrections submitted a request to assume the Revenue lease to allow for consolidation of staff from two existing facilities, the state-owned Health Services Building and leased space in Franklin County. She said negotiations with the lessor resulted in an offer to provide a full eight year lease term and to provide storage in the facility at no cost while Revenue locates to the State Office Building.

This lease was modified rather than bid because advertisement is not required under KRS 56.805 when the lessor is a governmental entity. The Kentucky Retirement Systems, which owns the Perimeter Park building, is considered a political subdivision of the state. Ms. Brownlee said if this proposed consolidation is approved and funded, the space Corrections will vacate in the Health Services Building will then be utilized to move staff from the Health and Family Services Cabinet from leased space.

Representative Wayne asked why the modifications were being submitted before funding was available. Ms. Brownlee said the Committee needed to be aware of both agencies plans for budget purposes, the leases will be over $100,000 a year, and modifications will be over $50,000. She said it was also fitting since the Committee is meeting in the State Office Building to show the ripple effect on the entire Franklin County market once the State Office Building came on line and its effect on other agencies. No action was required by the Committee.

Lastly, Ms. Brownlee discussed a lease modification for the Cabinet for Health and Family Services (CHFS) in Johnson County. This modification provides for an increase of 394 SF to accommodate new staff; a one-year extension of the lease term with an expiration of June 30, 2013; and conversion of two smoking rooms at a cost of $2,628. Ms. Brownlee said this item is being reported individually due to the amortization of the cost of converting the smoking rooms. The addition of the square footage in the lease will be reported with the quarterly report of square footage modifications.

Senator Buford said he receives calls from people in these buildings complaining that the smoking rooms do not work. Ms. Brownlee clarified that smoking rooms are being eliminated in state buildings so people would need to go outside to smoke.

In response to questions from Senator Buford, Ms. Brownlee said the number of smoking rooms provided in a building had been based on the scale of the office space, and were generally one per floor. She said there were none in the renovated State Office Building. No Committee action was required.

Senator Tori next welcomed Tim Thomas, Executive Director, Kentucky Infrastructure Authority (KIA) and Sandy Williams, Financial Analyst, to present a follow-up report from the Committee's November meeting. In November, it was reported that the KIA Board adopted a resolution at its October meeting to bring KIA projects to the Committee prior to the projects being bid.

Mr. Thomas presented a letter from the Kentucky Rural Water Association endorsing the pre-bid loan committal changes. He said this change was made to better meet the needs of program participants, provide more efficient service, and address an apparent disconnect between the state's infrastructure needs and participation in KIA programs. He said KIA should have seen a greater demand for its loans since KIA has the lowest interest rates available to Kentucky communities for infrastructure needs.

Mr. Thomas said KIA has learned that many eligible communities are looking elsewhere for loan funds or issuing their own bonds instead of utilizing the state revolving fund (SRF) programs, which are supported 80% by federal funds, for sewer and drinking water projects. He said the Authority's SRF programs are reviewed annually by the US Environmental Protection Agency (EPA) and receive very high marks in all areas except for program pace, where KIA constantly lags behind the national average. KIA has been directed by EPA to increase the number of SRF loans. To investigate this low demand for KIA funds, staff engaged utility company representatives, engineers, and consultants over the last two to three years to determine what might be affecting participation. The feedback was that the SRF was overly cumbersome, that the process had to be initiated too far ahead of the project construction schedule but with no resulting commitment of funds until the project was bid, and that the respective roles of KIA and the Division of Water (DOW) were not clearly defined.

Mr. Thomas said some features of the SRF programs are simply part of federal law and cannot be changed. However, some state regulations were reviewed and revised and some outdated and unnecessary requirements for borrowers were eliminated. Redundant documentation requests from both KIA and DOW were eliminated. Certain program features desired by borrowers were adopted, including the pre-bid conditional loan committal. This pre-bid loan committal process is a feature of other states' SRF programs and of several federal loan programs, including the US Department of Agriculture's Rural Development program. He said KIA is losing business to the federal program even though such loans carry higher interest rates than KIA.

Mr. Thomas said KIA would like to do more business with Louisville and Lexington with their larger projects, which would be the best and quickest way to increase the program pace. In one instance, one of the larger urban utilities indicated that KIA's inability to provide pre-bid commitments resulted in KIA loan programs not being a preferred option. That utility did not want to take the time and expense getting a project to the bid stage without some assurance that financing would be forthcoming.

Representative Wayne said he was concerned that the changes were essentially a way to bypass the oversight of the Committee. Mr. Thomas said KIA's relationship with the Committee will not change, and that if for some reason the borrower had to increase the requested loan amount in the future, if would need to be approved by the KIA Board and again come before the Committee for approval.

Senator Buford said local water districts and the communities can move their projects along faster by seeking financing on their own, despite the higher interest rates. In the end, they can pass the rate increase along to their customers. He noted the Public Service Commission (PSC) does not oversee the municipals, and it may be to their advantage to find alternative financing rather than go through KIA because of the loan process. He said he hoped the goal of KIA's changes was for the utilities to get the lower interest rates so customers would not have to pay as much for the water supply.

Representative Damron said the Committee was concerned about the timing of the change since it appeared to be politically motivated. He wanted to make sure KIA serves water districts that have a difficult time securing financing for their projects, as opposed to targeting the market in Lexington or Louisville where urban governments have access to capital markets. He was concerned that if KIA markets to the large water districts, they will take all the money and the rural water districts that really need KIA will be left out.

Representative Damron also said it is imperative that the interest rates charged be based on a mathematical calculation and not left up to the KIA staff, and he wanted clarity as to why different districts get different rates. He said he was concerned about the transparency and the decision-making process regarding the setting of rates.

Ms. Williams then presented a Fund B (Infrastructure Revolving Fund) loan for the Prestonsburg City Utility Commission in Floyd County, which is requesting a

$2,700,000 loan to purchase the Auxier Water System. The loan will have a 20-year term and 0.7% interest rate with an annual payment of $150,306.

Representative Damron asked if Auxier was within the city limits of Prestonsburg. Ms. Williams said it was not and that Auxier purchases water as a wholesale customer of the City. Auxier has 954 customers and Prestonsburg has 7,000. To further the goals of Senate Bill 409 they are combining management under a regional approach.

Representative Damron asked what representation the rate payers of Auxier have with the City of Prestonsburg and if KIA was building anything else into the loan request that would ensure that the City does what it is supposed to do to treat the people fairly. He commented that currently Auxier would be under the PSC. Ms. Williams said it was not a condition of the KIA loan to outline management structures for the combined utilities. Representative Damron said there is a problem when a city acquires water territories outside the city limits, the people outside the city limits have no representation.

Representative Wayne asked if anything could be done to ensure Auxier rate payers have representation, such as adopting a KIA regulation that if KIA financing is used to acquire a smaller entity, the new structure must provide for a representative voice for the people served by the smaller entity. Mr. Thomas said he would like to have legal counsel look into this before he could say that could be accomplished through regulation. He said it may have to be adjusted in KIA's statutes. Representative Wayne said a lot of small populations may be shut out in the process.

Representative Damron ask how the loan rate of .7% for the Auxier project was determined. Ms. Williams said currently there are three loan funds that the City of Prestonsburg could have used to finance this project. The first one is Fund F (Federally Assisted Drinking Water Revolving Loan Fund), but to be eligible, the project has to be on the priority list and rank high enough on the scale to comply with the Safe Drinking Water Act. KIA does have a small amount of funds in Fund B (Infrastructure Revolving Loan Fund with state-supported debt service) that can be used for system purchases and there are funds in Fund C (Governmental Agencies Program - no state supported debt service) that could also be used. The Fund B was the alternative the City selected and they received the discounted Fund B rate because the median household income in Floyd County and Prestonsburg is less than the median income of the state.

Representative Damron said he understood that rationale but thought the focus of the 2020 plan was to provide safe drinking water across the Commonwealth. When $2.7 million is taken from a fund that could be used to extend waterlines throughout Floyd County but instead is used by the City of Prestonsburg as a low interest loan to acquire a water system, it raises concerns about KIA's decision-making and prioritization process.

Mr. Thomas said the KIA Board takes each of these instances separately and the circumstances of each are different. He said very often the PSC and the Division of Water may have a troubled water system they are tying to assist and they may be talking to neighboring systems about a merger or some type of take-over. Representative Damron asked if Auxier was a troubled system. Mr. Thomas said he did not know. In response to another question, Ms. Williams said Auxier was a privately owned water system.

Senator Buford made a motion to approve the loan. The motion was seconded by Senator Seum and passed by roll call vote. Five members voted affirmatively, and two members voted to pass.

Representative Wayne explained his "Pass" vote. He said he was concerned that the rate for Auxier system ratepayers was going to be twice as much as the people of Prestonsburg were paying.

Ms. Williams next presented a Fund F loan for $2,192,700 for the Bullock Pen Water District in Grant and Kenton Counties to construct water lines in Kenton County, replace a water main in Grant County, construct a new pump station in Kenton County, and construct a master meter with the Northern Kentucky Water District. The loan will have a 20-year term at 3.0% interest. These funds will be combined with local funds for a total project scope of $2,320,700.

Representative Denham made a motion to approve the loan subject to meeting the conditions of the KIA Board. The motion was seconded by Senator Seum and passed by unanimous roll call vote.

The last loan Ms. Williams presented was a Fund F loan for $1,999,250 for the City of Hardinsburg in Breckinridge County to extend water service. These funds will be combined with other project financing for a total project scope of $4,165,000. The loan will have a 20-year term and a 1.0% interest rate.

Representative Wayne asked why the new customers were being charged the highest rate instead of an average rate since there was a multiple rate structure. Ms. Williams said the City has a staggered rate system based on the cost associated with providing service to specific areas and this service area falls within the higher cost area.

Representative Rudy made a motion to approve the loan. The motion was seconded by Representative Wayne and passed by unanimous roll call vote.

Representative Damron said he voted "Yes" because KIA provided a discounted rate for customers where costs associated with serving those customers is relatively high.

Ms. Williams next reported the allocation of unobligated bond pool funds of $2,070,040 for six projects. These funds are available because the 2005 General Assembly authorized more bond funds for water and sewer projects than the total amount of line-item grants listed for these projects in the 2004-06 budget. The amount by which bond funds exceeds project line items is $5,943,820.

Representative Denham asked how much would be left in the unobligated bond pool, provided these are approved today. Mr. Thomas said approximately $3.8 million for tobacco projects remained, but no funding was available for coal projects. Mr. Thomas said no grant funds had been dispersed.

Representative Wayne asked if there was a public notice for these grants. Mr. Thomas said there was not. The KIA Board decided that a portion of the available funds would be made available for projects that had urgent funding needs. Those type of projects do not fit the public notice process. Representative Wayne asked Mr. Thomas how he felt about there not being any public notice for these grants. Mr. Thomas said some opportunities might have been missed if this funding were not forthcoming in a timely fashion.

Representative Wayne said by not providing public notice of the availability of funding, it shuts districts in need out. Ms. Williams said that KIA actively participates with all 15 water management councils, which have representation from utilities and local governments, and if there is an urgent need, many do call and ask if funding is available for a particular project. KIA did not publicly announce these funds, however, KIA does make itself available to the public through the water management councils.

Representative Wayne said he was concerned for community leaders who are not familiar with the bureaucracy of Frankfort and find it intimidating. He wondered if there was an application process with written criteria. He said the Committee tries to do its job in a transparent manner, and when KIA does these kind of things it is upsetting and makes one wonder if there is something political going on behind the scenes. Mr. Thomas said KIA often receives letters and phone calls directly from utilities and elected officials seeking assistance for their projects.

Representative Wayne said the process will appear arbitrary if KIA does not have a transparent and objective criteria-based process. Mr. Thomas said since the budget bill did not set out any criteria for these unobligated funds, the KIA Board used criteria from other programs, such as protecting human and environmental health, whether it was an unserved or underserved area, and whether there was an economic impact.

Representative Wayne asked if all those criteria were considered by the KIA Board in the decision-making process. Mr. Thomas said no, not with an objective, numerical process. Representative Wayne said this might be something to consider and that KIA should be as objective and transparent as possible. Mr. Thomas said he appreciated Representative Wayne's comments and would relay them to the board.

Senator Tori asked if the projects funded with unobligated bond pool funds were from a backlog of unfunded projects over the years. Mr. Thomas said some of them could have been in that circumstance. In one instance, KIA paired the unobligated money with line-item money. At least one project was an economic development project that was fairly timely in nature and the community needed to come up with some money. He said the board tried to leverage non-state dollars with grants as best as it could to see if there was federal money, local money or private money that might also go towards the individual projects. The board was not inclined to fully fund a project; the project financing packages run from 14% or 15% up to half for most of these projects.

Representative Damron said the state has the tightest budget it has had in at least four years and there are a lot of projects that need funding. He said he believed the decision to spend $6 million of the taxpayers' money should be made by the legislative members, especially when its this close to the budget cycle. He said he could not vote to give appropriation authority to five or six people at KIA and that the legislators are the public policy makers who should decide which projects are funded. If these are great projects, they will come through the budgetary process. He said he disagreed with the process, and the money should not be allocated unless the General Assembly votes for it.

Representative Wayne said the role of the Capital Projects and Bond Committee in this process is to not approve how this was done. He said that message needs to be clear.

Representative Denham made a motion to approve the unobligated bond pool allocations. The motion was seconded by Senator Seum and passed by roll call vote. Five members voted affirmatively two members voted no.

Representative Damron said he voted "No" and reminded the Committee that even if the grants are disapproved, the Secretary of the Finance Administration Cabinet can make the final determination.

Representative Denham explained his "Yes" vote by saying there was over $6 million in unobligated bond pool funds that had been appropriated, and the executive agency that has the expertise was implementing the program. The KIA Board is empowered by statute to implement the program.

Representative Wayne explained his "No" vote by saying he was not voting against a specific project, but the process itself.

Senator Tori explained her "Yes" vote by saying it would not be good to hold the projects up since KIA reviewed these allocations and has given its approval.

Ms. Williams next reported various coal/tobacco development grants that were funded through line-item appropriations from the General Assembly in 2004 and 2006. No action was required by the Committee.

Ms. Williams then presented a grant spend down and arbitrage report that showed the amount and percentage of funding spent from the 2000-02, 2002-04, 2004-06 and the 2006-08 budget authorization for KIA bonds. The information was requested by the Committee.

Senator Tori asked if there was any arbitrage penalty. Ms. Williams said KIA issued bonds in 2001 to fund a $50 million authorization for 2020 grants. That arbitrage report was completed in 2007 and there was no arbitrage required.

Senator Tori asked Terri Fugate, Deputy Executive Director, Office of Financial Management (OFM), to discuss the new bond issue: Kentucky Economic Development Finance Authority (KEDFA) Adjustable Rate Industrial Building Revenue Bonds, Series 2007 (Goodwill Industries of Kentucky, Inc.) $10,000,000. The proceeds from this issue will finance a portion of the cost of construction and equipment of five new and one relocated Goodwill donation center. These donations centers are located in Campbellsville, Danville, Maysville, Middletown, and two centers in Nicholasville.

In response to questions from Representative Denham, Ms. Fugate said the interest rate on these bonds had not been determined yet, and for this bond issue the Commonwealth serves as a conduit.

Representative Denham asked if other corporations could utilize KEDFA. Ms. Smith came to the table. She said KRS Chapter 103 sets forth the procedures and criteria for issuance of revenue bonds, and that for-profit corporations as well as non-profit corporations can apply to KEDFA for the issuance of conduit bonds. She noted that KEDFA encourages the local community to be the conduit for revenue bonds, but if the bond amount is large or the project has multiple locations, the local community may refer the corporation to KEDFA.

In response to questions from Representative Denham, Ms. Smith said Goodwill does have multiple locations, it is a 501(c)(3), and they were eligible for conduit bonding. She added that a KEDFA conduit bond project was done with Goodwill in 2000.

Representative Rudy made a motion to approve the bond issue. The motion was seconded by Senator Seum and passed by unanimous roll call vote.

The last bond issue Ms. Fugate reported was Kentucky Housing Corporation (KHC) Conduit Multifamily Mortgage Revenue Bonds, Series 2007 (Overlook Terraces

Project) $10,000,000. Walter Clare, Director of Financial Management, KHC, joined Ms. Fugate. Ms. Fugate said the proceeds from this issue will finance the construction of 144 units of low-income multifamily housing located on Glimmer Way in Louisville.

Senator Seum said he was familiar with a housing complex on Glimmer Way that was demolished because it was not usable. It was 20 years old and unrentable. He said nobody wanted to travel up the high road and the complex had a hard time getting water.

Mr. Clare said as a conduit issuer, KHC does not do a lot of due diligence on the projects' programming; however, KHC does make sure both the market study and the design work indicate a financially sound project that KHC feels comfortable putting its name on the issue. That is KHC's "perception risk" - the public perception of a project. He said in this case KHC staff feels comfortable with the developer's ability to do the project and that the project will operate successfully. Mr. Clare added that this is the same developer of the Falcon Crest project.

Senator Seum said that he had a problem with this project. The building that was demolished was not more than 20 years old and could have been renovated very easily and now the plan is to build a new building on top of what was there.

Senator Buford said this would be the total responsibility of the developer and if it does not meet its obligations the state would have no financial responsibility. He said this just states that the Committee has looked it over and found the details of the finance summary were in order.

Mr. Clare said KHC takes "perception risk" seriously even though KHC and the state have no financial risk. He said just because KHC does not have any financial risk, the lender, the tax credit investor, and KHC look at the project to determine if it is going to be a successful or affordable housing project for the required term of 30 years.

Susan Harrison, Development Coordinator, LDG Development, said the site was on Glimmer Way and was in a subdivision. She said they had meetings with the members of the subdivision who were happy they were going to build. The site was bulldozed because some of the building had slid; the previous developer did not do proper geological/engineering studies. The building had condos, and did not provide low-income housing. LDG has worked with the City of Louisville to do two geo-tech surveys and a geo-tech firm is to be on the site while construction is done. Ms. Harrison said there is currently a water tank on the hill and they are working with the Louisville Water Company to supply water to the site. The fire department has given LDG its approval as long as there is no gate that prevents the department from reaching the site. LDG has had to widen the road to increase access.

Senator Buford made a motion to approve the bond issue. The motion was seconded by Representative Rudy. The motion failed with four members voting yes, one member voting no, and one member voting to abstain.

Ms. Fugate then presented five follow-up reports for previously approved bond issues: Kentucky State Property and Buildings Commission Revenue Bonds, Project No. 88, dated November 15, 2007, $267,055,000; Kentucky Asset / Liability Commission (ALCo) University of Kentucky General Receipts Project Notes 2007 Series B, dated November 29, 2007, $80,245,000; ALCo Project Notes 2005 Agency Fund Second Series Note Program, Series A-5 (Kentucky River Authority), $14,025,000; KHC Revenue Bonds, Series N and O, dated November 29, 2007, $50,000,000; and KEDFA Revenue Refunding Bonds (Christian Care Communities, Inc. Obligated Group) Series 2007 A and B, $14,850,000. No Committee action was required for these follow-up reports.

Ms. Fugate also presented the annual report of bonds outstanding as of June 30, 2007, as required by KRS 45.810. No Committee action was required.

Ms. Fugate then presented six new school bond issues with School Facilities Construction Commission (SFCC) debt service participation: Adair County, Breathitt County, Clay County, Owen County, Pendleton County, and Rockcastle County.

Representative Rudy made a motion to approve the school bond issues. The motion was seconded by Senator Seum and passed by unanimous roll call vote.

Next Ms. Osborne reported that there were two locally–funded school bond issues submitted to the Committee for review this month for the Kentucky Interlocal School Transportation Association and Jefferson County. She said all disclosure information has been filed, and no further action on the bond issues was required.

Ms. Osborne noted at last month's meeting, the Committee asked for a list of donors for the Kentucky Community College and Technical System (KCTCS) Emerging Technology Center project at West Kentucky Community and Technical College (WKCTC). Dr. Barbara Veazey, President of WKCTC, has provided a list of donors.

Senator Tori said the Committee's next meeting is tentatively scheduled for January 15, 2008 in the Capitol Annex building. With there being no further business, a motion was made and seconded to adjourn the meeting. The meeting adjourned at 3:30 p.m. A tour of the renovated State Office Building followed the meeting.